IMF

SURVEY

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IMF's Executive Board Approves Renewed and Enlarged ESAF

Following discussions on renewing the IMF's concessional lending window—the enhanced structural adjustment facility (ESAF)—the IMF's Executive Board approved the renewal, to become operational early in 1994. Discussions are in the final stages with IMF members to establish both a capital account of SDR 5 billion (about $7 billion) and a subsidy account of SDR 2 billion (about $3 billion) for the renewed ESAF. IMF management has called upon member countries to complete their pledges as soon as possible. To date, these pledges have reached about 80 percent of the amount needed for the subsidy account. Meanwhile, the Executive Board has agreed to extend the commitment period under the current ESAF until February 28, 1994, to ensure a continuity of concessional lending by the IMF.

Downtown Kampala: Ugandan reform efforts have been supported by the ESAF.

The terms and conditions of the enlarged ESAF will be the same as those of its predecessor. It will provide loans to low-income IMF member countries that are undertaking economic reform programs to strengthen their balance of payments and improve their growth prospects; these programs are set in a three-year *(Please turn to page 4)*

Design Changes

The *IMF Survey* introduces a few design modifications with this issue. These include moving the table of contents to the back page and varying the color used in our issues.

Camdessus Hails Conclusion of Uruguay Round Negotiations

In a statement issued on December 15, IMF Managing Director Michel Camdessus expressed great pleasure at the conclusion of the Uruguay Round of trade negotiations. "This is the long-awaited outcome of seven years of negotiations aimed at strengthening the multilateral trading system and securing further market liberalization," he said.

"The conclusion of the Round should help to stem protectionist pressures and contribute to enhancing global business confidence and the prospects for world economic growth," according to Camdessus. "The more open markets should also serve as an important complement to the structural adjustment efforts undertaken by IMF member countries for sustainable growth." He applauded the participating countries for their willingness to take the difficult decisions needed to resolve the many complex issues addressed in the Round, and said he looked forward to governments moving expeditiously to implement the results of the Round. "The IMF will welcome a collaborative relationship with the World Trade Organization established under the Round," Camdessus added. (See page 2 for highlights of the Uruguay Round agreement.)

Trade Agreement Mandates Broad Changes

On December 15, 1993, in Geneva, 117 countries reached consensus on the contents of the Final Act of the Uruguay Round—the eighth and most ambitious Round of multilateral trade negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT). The agreement brought to a close more than seven years of often contentious trade talks. The Final Act would, after ratification by the relevant national authorities, cut tariffs on industrial goods by an average of more than one third, progressively liberalize trade in agricultural products, and convert the GATT from a provisional agreement into a formal international organization, to be called the World Trade Organization (WTO).

The WTO will serve as a single institutional framework encompassing the GATT and all the results of the Round. It will be directed by a Ministerial Conference that will meet at least once every two years, and its regular business will be overseen by a General Council. Countries must accept all of the results of the Uruguay Round, without exception, to become WTO members.

The Final Act's 550 pages include about 15 separate agreements, annexes, decisions, and understandings that would, among other things, bring trade in agricultural products, services, textiles and clothing, and intellectual property within the ambit of the WTO. The agreement would also discipline the use of subsidies and countervailing measures, and technical barriers; tighten antidumping rules and eliminate certain restrictive trade-related investment measures; strengthen existing measures to open up government procurement to foreign suppliers; regulate the use of restrictive safeguard actions; strengthen and clarify procedures for the settlement of trade disputes among WTO members; and increase the transparency of national trade policies by confirming and widening the scope of the Trade Policy Review Mechanism.

Highlights of the Final Act's provisions are as follows:

• ***Industrial Products.*** Under this agreement, tariffs on industrial products are to be reduced by more than one third on average. In industrial countries, tariffs would be eliminated in several sectors (for example, steel, pharmaceuticals, and wood and wood products). Developing countries would both lower their tariff barriers significantly and increase the number of their "bound" tariffs (which constitutes a commitment not to raise them without consultation and compensation).

• ***Agricultural Products.*** Member countries are encouraged to give agricultural trade a stronger market orientation, primarily by (1) reducing export subsidies and (2) converting all nontariff barriers to tariffs ("tariffication," which increases the transparency of support) and then steadily reducing the latter by about 36 percent on average. Subsidized export volumes will be reduced over time by 21 percent. Both the subsidy and tariff reductions envisaged are to be completed within six years for industrial countries and ten years for developing countries, with the "least developed countries" effectively exempted from such commitments. Since the cutting back of subsidies is likely to reduce the quantity of agricultural products dumped on world markets, there is a possibility of a short-term increase in costs for developing countries currently importing substantial quantities of subsidized food. Consequently, a special decision is included that provides transitional help through possible food aid and support for agricultural development. The Final Act recognizes that "least developed countries" and "net food-importing developing countries," to the extent that they experience external payments problems, would be eligible to receive financing from the IMF and the World Bank from existing and newly emerging facilities.

• ***Services.*** A framework agreement includes basic obligations of all member countries on international trade in services, including financial services, telecommunications, transport, audiovisual, tourism, and professional services, as well as the movement of workers. Among the obligations is a most-favored-nation (MFN) obligation that essentially prevents countries from discriminating among foreign suppliers of services. In addition, countries have made specific commitments on liberalizing certain services sectors. These commitments include national treatment (that is, to treat foreign suppliers of services like domestic suppliers) and provision of market access. Negotiations on telecommunications, audiovisual, and maritime services are to resume after the ministerial signing of the Final Act. Furthermore, after implementation, participants will have the opportunity to take exemptions from MFN obligations in financial services. The framework agreement also establishes the basis for progressive liberalization of international trade in services through successive rounds of negotiations, which also applies to other agreements under the Final Act.

• ***Textiles and Clothing.*** Under this agreement, bilateral quotas negotiated

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under the existing Multifiber Arrangement (MFA) are to be completely phased out over a ten-year period beginning with the entry into force of the agreement. The quotas that remain during this period will be progressively increased to allow further market access.

• ***Intellectual Property.*** This agreement provides for improved levels of protection for the rights of owners of all types of intellectual property (for example, patents, copyrights, trademarks, and trade secrets). These levels are achieved principally by requiring countries (1) to grant national treatment; (2) to provide certain minimum standards of protection for all types of intellectual property (for example, 20 years for a patent); and (3) to institute procedures and remedies under national laws so that foreigners can enforce their rights.

• ***Subsidies.*** The agreement defines three categories of subsidies: (1) prohibited subsidies—those contingent upon export performance or the use of domestic instead of imported goods; (2) actionable subsidies—those that have demonstrably adverse effects on other member countries; and (3) nonactionable subsidies, including those provided (with stipulated limitations) to industrial research and precompetitive development activity, to disadvantaged regions, or to existing facilities to adapt themselves to new environmental requirements.

The agreement also puts restrictions on the use of countervailing measures introduced in response to competitors' subsidies. To prevent undue hardships, developing countries and countries in transition from centrally planned to market economies are allowed extra time to bring their subsidies into conformity with the new rules.

• ***Technical Barriers.*** The agreement seeks to ensure that technical negotiations and standards, as well as testing and certification procedures, do not create unnecessary barriers to trade. To this end, it encourages countries to use international standards, but does not oblige harmonization of standards. At the same time, it recognizes the right of countries to establish protection—for example, for human, animal, or plant life; health; and the environment—at levels they consider appropriate, and specifies that they should not be prevented from ensuring that their desired standards are met.

• ***Antidumping Rules.*** The agreement provides greater clarity and more detailed rules concerning the method of determining dumping and injury, the procedures to be followed in antidumping investigations, and the duration of antidumping measures. It also clarifies the role of dispute-settlement panels in conflicts relating to antidumping actions taken by national authorities. A number of issues that could not be sorted out have been delegated to the Committee on Antidumping for resolution.

• ***Trade-Related Investment Measures.*** The agreement requires the elimination of certain restrictive measures (such as local content and foreign exchange balancing requirements) that violate GATT principles of national treatment and prohibition of quantitative restrictions.

• ***Government Procurement.*** The Final Act contains procedures designed to facilitate the membership of developing countries in the existing Government Procurement Agreement. In addition, negotiations on a new Agreement on Government Procurement, not formally part of the Uruguay Round, are proceeding and are expected to conclude in the near future. The objectives of these negotiations include broadening the coverage of the Agreement to include services as well as (already covered) goods and to include procurement by levels of government that are subordinate to central governments.

Raising sheep in Spain. The Uruguay Round agreement progressively liberalizes agricultural trade.

Safeguard Actions. Article XIX of the GATT allows members to take safeguard actions—import restrictions to protect a domestic industry from the negative effects of an unforeseen import surge—if a domestic industry is threatened with serious injury. The new agreement, however, prohibits the use of such actions where they constitute "grey-area" measures, including voluntary export restraints, orderly marketing agreements, or other similar measures applied on either exports or imports. "Grey-area" measures currently in effect are to be phased out within four years after establishment of the WTO. Furthermore, the agreement provides discipline on the use of *all* safeguard measures taken under Article XIX, including time limits, requirements for safeguard investigation, and nondiscrimination (generally) among sources of supply. Developing countries would be granted protection against the introduction of safeguard actions by their trading partners where the developing country's share of the partner's domestic market is relatively small.

• ***Dispute Settlement.*** The Final Act provides for further strengthening the existing dispute-settlement system of the GATT. This system had already been strengthened and streamlined as a result of the Mid-Term Review Ministerial Meeting on the Uruguay Round, which was held in Montreal in December 1988. It lends greater automaticity to the adoption of the findings of both panels charged with settling trade disputes and of the new Appellate Body designed to hear appeals of panel findings. It also provides for "crossretaliation" (withdrawal of benefits in one sector for violation of rules in another sector). The broadened coverage of world trade under the Final Act and the WTO's reliance on a single dispute-settlement system would considerably increase that system's importance. The understanding also seeks to limit unilateral determinations that trade rules have been violated (by affirming that members shall not themselves make determinations that a violation has occurred), and instead promote the use of the WTO dispute-settlement rules and procedures to seek redress. The understanding also makes special provision for protection of the interests of both developing countries and least-developed countries. Finally, it provides recourse for members who feel that their benefits are being nullified or impaired, albeit without any direct violation of obligations.

• ***Coherence in Global Policymaking.*** The Final Act notes that greater exchange rate stability based on more orderly underlying economic and financial conditions should contribute to "the expansion of trade, sustainable growth and development, and the timely correction of global imbalances." Recognizing the important linkages between trade policy and other economic policies, and the need for them to be mutually consistent, the Final Act calls on the WTO to strengthen its cooperation with the Bretton Woods institutions. It suggests that the Director-General of the WTO review with the Managing Director of the IMF and the President of the World Bank the implications of the WTO's future responsibilities for its cooperation with the two Bretton Woods institutions.

• ***Balance of Payments Provisions.*** The Final Act specifies that member countries imposing trade restrictions for balance of payments purposes should do so in a way that causes minimum disruption to international trade. To this end, price-based measures, such as import surcharges and import deposits, should be preferred to quantitative restrictions. The Final Act also strengthens current procedures that require countries using such restrictions to consult with the GATT. ■

ESAF Supports Low-Income Countries

(continued from front page) framework as laid out in policy framework papers, developed in collaboration with the World Bank. (See *IMF Survey*, September 20, 1993, page 279, for a review of the ESAF's track record.) Loans under the ESAF will continue to carry an interest rate of 0.5 percent and will be repayable over 10 years, with a grace period of 5½ years.

The Executive Board will determine when sufficient resources are on hand, or in firm prospect, for the enlarged ESAF to begin its lending operations. If resources are mobilized quickly in certain key capitals, the enlarged ESAF could come into operation even prior to the target date of February 28, 1994. So far, commitments and pledges have been received from 37 countries, an even broader spectrum of the IMF's membership than for the current ESAF. Developing countries, in particular, have increased their share of contributions from 8 percent currently to nearly 20 percent under commitments obtained to date for the subsidy account.

The ESAF is widely recognized as an effective mechanism for IMF support of low-income countries. The initial rationale for the ESAF remains relevant today: to help low-income countries with heavy debt burdens in a difficult external environment implement comprehensive macroeconomic and structural policy programs designed to strengthen their balance of payments and foster growth. It is also a key complementary element helping to increase the effectiveness of a growing network of bilateral and multilateral assistance.

Programs under the expanded ESAF are expected to pay greater attention to social safety nets; to include, where feasible, contingency mechanisms to protect programs against shocks; and to better integrate technical assistance. On social safety nets, the IMF will, in collaboration with the World Bank and other donors, continue to encourage and assist country authorities to integrate well-designed social safety nets into programs.

Steps to enhance such integration include: improving data and implementation capacity with timely technical assistance, increasing public spending in areas that directly benefit the poor, and improving the scope for financing social safety nets through cuts in unproductive expenditures. Programs will seek to give even greater emphasis to strengthening the quality of public spending. ■

Private Capital Flows to Developing Countries Show Sharp Increase

The resurgence of private financial flows to developing countries has continued over the past year. Much of the flows remain concentrated in those few Asian and European countries that avoided debt-servicing difficulties in the 1980s and in Latin American countries that were able to normalize their relations with creditors. Notwithstanding the resurgence of flows, the availability of financing remains extremely limited for many developing countries, particularly where difficult economic situations are compounded by unresolved debt problems. These and other developments in private market financing are discussed in *Private Market Financing for Developing Countries*, an annual IMF study.

New Private Financial Flows

The volume of securitized flows reached unprecedented levels in 1993, while the range of borrowers with access to private market financing broadened further. As borrowing in the international bond market recovered strongly after a market correction in the final quarter of 1992, the structure of securitized flows shifted markedly toward bond financing.

In contrast, the volume of international equity issues by companies from developing countries declined sharply in the second half of 1992 and remained subdued during the first half of 1993. Activity in the syndicated loan market continued to focus on countries that avoided debt-servicing difficulties during the 1980s, although there were signs of renewed interest in other borrowers on a highly selective basis. Finally, international investors began to invest sizable amounts in local–currency–denominated debt instruments.

Bonds. The rush of activity in the international bond market was aided by a general decline in long-term interest rates and investors' increasing appetite for high-yielding sub-investment grade debt. Those developing country borrowers that had strong economic policies in place were quick to take advantage of the favorable environment. The amount of bonds they issued doubled in 1992 and reached a record $21.7 billion in the first half of 1993.

Key trends in the bond markets for developing countries in the first half of 1993 were a pickup in the share of sovereign borrowing, better terms on new issues, continued reliance on enhancement techniques to reduce borrowing costs, and a broader range of developing country borrowers with credit ratings from major credit rating agencies.

Borrowers in the Western Hemisphere continued to dominate the market. They raised $11.2 billion during the first half of 1993, compared with $12.4 billion in all of 1992. Mexico, raising some $5.9 billion in the first half of 1993, maintained its position as leading borrower. The country's biggest cement producer, Cemex, issued the largest Eurobond ever by a Latin American borrower—$1 billion.

Another notable event occurred when Mexico's largest shipping company (TMM) issued $200 million in 10-year notes and became the first Latin American private sector borrower to tap the domestic U.S. bond market.

Asian borrowers also continued to expand their use of bond markets. In the first half of 1993, they raised $5.4 billion, slightly more than in all of 1992. Of that amount, China and South Korea raised $2 billion. By stepping up their borrowing, European developing borrowers raised $4.1 billion; the Czech Republic, Hungary,

Indicators of Private Capital Flows To Developing Countries

(billions U.S. dollars)

	1989	1990	1991	1992	First Half 1993
International bond issues	5.5	6.2	12.5	23.6	21.2
Of which					
Market re-entrants	0.8	2.6	7.1	13.0	11.5
International equity issues	...	1.2	5.4	9.4	4.1
Of which					
Market re-entrants	...	0.2	4.4	4.9	2.6
Bank lending commitments	15.1	17.9	27.0	17.0	8.9
Of which					
Market re-entrants[1]	0.3	1.0	1.0	0.9	0.5

[1]Excludes concerted lending

Data: IMF, *Private Market Financing for Developing Countries*

the Slovak Republic, and Turkey were the main issuers.

Equities. Weak equity prices on most of the main Latin American stock markets discouraged activity in international equity issues. In the first half of 1993, issues totaled $4.2 billion, compared with $5.4 billion in 1992. Among the handful of equity issues brought to market in the first half of 1993 was the Argentine Government's successful flotation of $2.1 billion shares in Yacimientos Petrolíferos Fiscales (YPF). Not only was this the largest single equity offering by a developing country, it was also one of the world's largest privatizations.

Asian companies sharply stepped up their equity issuance activity in 1992. They raised $4.7 billion that year and an additional $1.5 billion in the first half of 1993. Chinese and Hong Kong borrowers remained the two leading groups of Asian borrowers. Activity elsewhere in the developing world remained slight.

Bank Loans. Following a decline in bank loan commitments to developing countries in 1992, syndicated bank lending recovered somewhat in the first half of 1993, although banks continued to emphasize improving profitability and containing risk. As in previous years, access to syndicated bank credit was severely restricted for developing countries that had experienced, or were experiencing, debt-servicing difficulties.

Bank Debt Restructuring

To date 16 countries, accounting for about 80 percent of the bank debt of developing countries that rescheduled in the 1980s, have restructured or reached agreement to restructure their bank debt since August 1992.

Among the heavily indebted countries, Argentina and the Philippines completed debt-restructuring packages in 1992–93, while bank claims on Bolivia, Guyana, and Uganda were bought back at steep discounts. Brazil and the Dominican Republic have reached agreement on terms for debt restructurings, and Jordan recently completed its debt-restructuring package. Other countries are still negotiating with bank creditors.

Where commercial bank debt problems have been overcome, the report credits two elements:

- The persistent pursuit of stabilization and reform programs by the debtors. This resulted in stronger external positions that allowed a debtor country to accumulate needed reserves for debt reduction.
- The willingness of both creditors and debtors to adapt to changing circumstances and to the constraints faced by each.

The number of middle- and lower-middle income countries still to come to terms with bank creditors is now limited. Many of these remaining countries have already begun negotiations with creditor banks (Bulgaria, Ecuador, Panama, Peru, and Poland). Even with good policies, in the absence of debt restructuring, a number of these countries face difficult external prospects.

For the low-income countries, many still have bank debt problems. In these countries, international banks generally do not have significant long-term business interests; in similar situations elsewhere, they have been prepared to accept buy-back offers at steep discounts. Resolving these cases will require adequate concessional resources to finance both the operations themselves and the related technical assistance.

Prospects

Despite positive developments in commercial bank debt restructuring and private market financing, the IMF's report cautions against too much optimism. Those countries that are still striving to restructure their external debt to commercial banks face difficult external prospects, and they

Bank Debt Restructurings and Bank Financial Packages

(agreement classified by month of signature)[1]

1991
Colombia: April[2]
Niger: April
Uruguay: January[3]
Brazil: May[4]
U.S.S.R., former: December (deferment)
Mozambique: December
Nigeria: December

1992
Algeria: March
Gabon: May
Brazil: September[3,5]
Guyana: November
Philippines: July[3]
Argentina: December

September 1993
Uganda: February
Bolivia: March
Russia: July[6]
Dominican Repubic: August[5]
Jordan: August[5]
South Africa: September

Under Negotiation
Albania, Bulgaria, Ecuador, Nicaragua, Panama, Peru, Poland, Sao Tome and Principe, Sierra Leone, Tanzania, Zambia

[1]Agreement either signed or reached in principle (if signature has not yet taken place); not all signed agreements have become effective.
[2]Refinancing agreement.
[3]The restructuring agreement includes new financing.
[4]Preliminary agreement on interest arrears.
[5]Agreement on term sheet.
[6]Agreed in principle or tentative agreement with banks' Steering Committees..

Data: IMF, *Private Market Financing for Developing Countries*

Photo credits: Embassy of the Republic of Uganda, page 1; Keith Wood for Tony Stone, page 3; Denio Zara for IMF, pages 7 & 8; Government of Cape Verde, page 16.

must take care to pursue sound macroeconomic policies, even after restructuring their bank debt.

With regard to the durability of market re-entry, private capital flows to developing countries can only take place within an appropriate framework. This includes sound macroeconomic policies, adequate reserves, and a productive market-oriented economy, but also requires a growing investor base, appropriate pricing of risk, and the matching of future debt-servicing requirements to payments capacity.

For the economies in transition to market systems, bold steps in reducing state ownership, establishing a clear legal and regulatory framework, and removing restrictions on remittances of profits and dividends from foreign investments are critical in attracting private financing. Sustaining such financing will then depend on developing a strong corporate sector and efficient and well-regulated financial markets and institutions. ■

Juanita Roushdy
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Private Market Financing for Developing Countries, by a staff team led by Charles Collyns, is part of the IMF's World Economic and Financial Surveys series and covers events from August 1992 to September 1993. It discusses a number of other issues in detail, including commercial bank debt restructuring, lessons from recent experience of re-entry to international securities markets, and changing structures of commercial bank lending. Copies are available for US$20.00 each (US$12.00 for full-time university faculty and students) from Publication Services, Box S-382, International Monetary Fund, Washington, D.C. 20431, U.S.A. (Telephone: (202) 623-7430; fax (202) 623-7201).

IMF Addresses Poverty in Structural Adjustment Programs

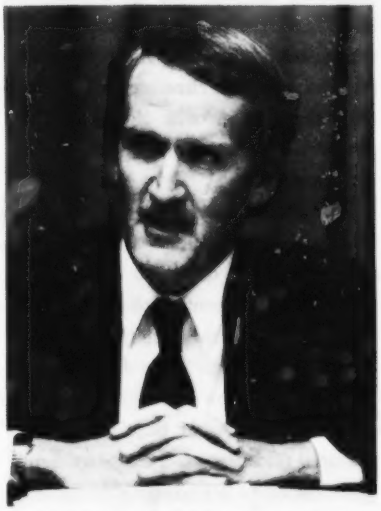
In response to experience and some external criticisms of structural adjustment programs, the IMF has sharpened its focus on poverty in the context of formulating structural adjustment programs for low-income developing countries. Indeed, IMF Managing Director Michel Camdessus now frequently stresses the need to promote "high-quality growth" that addresses poverty and other social concerns.

The following article describes two presentations on these issues made by IMF economist James Boughton and Bread for the World official Nancy Alexander at a November 18 seminar at the IMF Visitors' Center. Boughton's comments were based on "Adjusting to Development: The IMF and the Poor," a paper he co-authored with Boris Bernstein, a 1992 summer intern at the IMF who is currently with Goldman Sachs International in London.

The IMF's concern for the effects that structural adjustment programs have on the poor has assumed considerable importance since the beginning of the 1980s. This increased concern stems from a number of factors: changing lending patterns, external developments, and the findings of IMF staff studies. James Boughton, IMF Historian and formerly Advisor in the Research Department, described this evolution in his presentation.

The Changed Pattern of IMF Lending

Since the mid-1970s, developing countries have become the major users of IMF resources, according to Boughton. The major industrial countries borrowed large amounts in earlier decades, but have not borrowed from the IMF since 1977, when Italy and the United Kingdom undertook stand-by arrangements. Boughton attributed the decline of industrial country borrowing from the IMF—which he characterized as a "huge sea change" in the IMF's activities—to the collapse of the par value exchange rate system during 1971-73 and the proliferation of alternative funding sources for these countries. At the same time, developing countries' demand for IMF resources have increased dramatically. Stagflation in the global economy during the late 1970s, the debt crisis in developing countries, the collapse of commodity prices after 1984 (and the consequent worsening of developing countries' terms of trade), and the failure of many countries to adjust promptly to economic shocks have all contributed to the need for assistance.



Boughton: The IMF has sharpened its focus on poverty in the context of structural adjustment programs.

The IMF's traditional lending practice, developed in the 1950s, provided members facing balance of payments problems with stand-by arrangements

that typically lasted one year. By the 1970s, Boughton noted, such short arrangements were no longer suited to the problems developing countries faced. From then on, these countries faced deep-seated structural problems—both internal and external—that could be effectively addressed only through massive changes in domestic policies and longer-term financial support.

The IMF responded by creating the extended Fund facility (EFF) in 1974 to address the need for major economic adjustments that required longer periods and larger amounts of financial support. The EFF, which permits members to repay drawings over 10 years rather than the 5 years required under stand-by arrangements, contributed to a considerable increase in IMF lending to developing countries in the late 1970s.

Problems in Implementing Adjustment Programs

As the governments of developing countries increasingly took steps in the 1970s and early 1980s to respond to adverse shocks and to correct for earlier excess borrowing and spending, the burden of adjustment often fell on the most vulnerable groups in society. Social disturbances, some with tragic consequences, occurred in several countries, reflecting the severe strains associated with adjustment programs. In this context, governments sometimes used the IMF as a scapegoat for unpopular measures they were taking.

In early 1989, Venezuela announced price increases for petroleum products and public transportation as part of an IMF-supported structural adjustment program. Rioting resulted, and Venezuelan President Carlos Andres Pérez wrote to Michel Camdessus criticizing the IMF for its role in formulating the program. Camdessus replied that while the IMF supported the adjustment measures included in the program, it was "a prerogative of sovereign states to decide themselves what measures are required for recovery, however unpleasant those measures may be." The letter, published in major newspapers and in the *IMF Survey* (March 20, 1989), marked a turning point in the IMF's relations with member countries. It indicated publicly that countries themselves were ultimately responsible for their adjustment policies.

The IMF Responds to Criticism

While the IMF was gaining experience in helping developing countries design and implement structural adjustment programs and in understanding the political realities their governments faced, it was also listening to criticism from academics, nongovernmental organizations (NGOs), and even from other official organizations. For example, Boughton cited the World Bank's 1984 *World Development Report*, which raised questions about the traditional adjustment paradigm that focused almost exclusively on a country's macroeconomic aggregates. Boughton added that, among others, Tony Killick of the Overseas Development Institute, Richard Jolly of the United Nations Children's Fund (UNICEF), and Jeffrey Sachs of Harvard University had each criticized the IMF's approach to structural adjustment. In addition, Jacques Polak, IMF Director of Research for many years and subsequently an Executive Director, wrote in 1991 that the IMF's traditional "trickle-down" approach to adjustment was not sufficient for addressing poverty issues.

While acknowledging the criticism, Boughton pointed out that there was still "no solid economic theory of the distribution of income or the relationship of the income distribution to economic growth." Consequently, there was still no basis for the IMF or other international financial institutions to make recommendations about the "right" type of income distribution that should result from structural adjustment programs. He noted that many studies had concluded that although adjustment programs clearly affected a country's income distribution, the effects could be positive (in the sense of distributing income more equally) or negative, depending on the structure of the economy and the adjustment program.

In light of the uncertainty about the effects of adjustment programs on income distribution, Boughton said, the IMF's traditional practice has been to avoid commenting on a member country's distribution of income—which has been viewed as being outside the IMF's mandate—or making IMF loans conditional on changes in income distribution. He noted, however, that the IMF staff has produced a number of detailed studies since the early 1980s, including case studies of adjustment in low-income countries, that have gone far toward identifying structural policies that could mitigate the effects of adjustment on the poor. Following discussion of these findings by the Executive Board and in more

SDR Rates

Week Beginning	Interest and Charges (percent)
Dec. 13	3.92
Dec. 20	3.95
Dec. 27	3.96
Jan. 3	3.89
Jan. 10	3.87

The rate of SDR interest and charges is calculated weekly, by reference to a combined market interest rate, which is the weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (U.S. dollar, deutsche mark, Japanese yen, French franc, and pound sterling). The interest rates used are those that prevail each Friday. For the latest weekly rates call (202) 623-7171.

Data: IMF Treasurer's Department

public forums, the IMF—in cooperation with other agencies—is now able to focus more specifically on preserving programs that benefit the poor and on helping to set up social safety nets for the disadvantaged.

Boughton concluded that the IMF, much like a doctor, does its best to follow the precept, "First, do no harm" as it helps countries design programs that minimize the social costs of adjustment. He cautioned that the IMF can assist only in the effort to design good programs, adding, "it's still up to the governments. Only when the government itself sees the need to implement a program that protects the poor can the IMF be an effective partner in the process."

Alexander: The IMF should take a more multidisciplinary approach to studying its member countries' problems.

An NGO Perspective

Nancy Alexander, Director of Issues at Bread for the World (a U.S. nongovernmental organization made up of Christian churches and individuals), questioned the relevance of the IMF, which was set up almost 50 years ago, to today's world. She said that many developing countries are currently repaying larger amounts to the IMF and the World Bank than they are receiving in financial assistance and asked whether the resulting net outflow of funds from these countries is undermining their economic development. The IMF has been criticized in some quarters for its work on structural adjustment, she said, since it "is really a force in centralizing economic power in the world rather than helping [people in developing countries] get more broad-based access to assets."

During the 1960s, some countries enjoying high rates of economic growth saw their distribution of income become more unequal and experienced increases in the incidence of poverty, Alexander said. The IMF's traditional focus on increasing member countries' rates of economic growth led it to neglect the interests of the poor. International financial institutions should encourage their members to adopt adjustment policies that are more equitable and in tune with their historical patterns of economic growth.

Alexander criticized the social safety net measures incorporated into IMF and World Bank programs on the grounds that while they eased some people's hardships, they do not alter the pattern of economic growth to make income distribution more equitable and alleviate the plight of the poor.

Alexander conceded that structural adjustment programs have some positive effects. She cited the experience of Kenya where, following an adjustment program, more goods were available in shops and a building boom took place in some urban areas. The accompanying increase in wealth, however, was concentrated among relatively few people. The middle class was squeezed by increased fees for education and health services, and the poor, in her view, were "considerably worse off than before adjustment."

The IMF should ensure that its work is done with greater transparency and openness, Alexander stated, and the organization should take a more multidisciplinary approach to analyzing its member countries' problems. She suggested that IMF missions to member countries include meetings with a wider range of people, including officials of more government ministries and departments, NGOs, local UNICEF offices, and organizations that represent the poor.

The IMF, Alexander commented, can exert effective leverage on its member countries to induce them to change their environmental policies or alter the existing distribution of national income. She called the IMF's perception that it is limited by the need to respect the sovereignty of its members "an illusion."

Discussion

During the question-and-answer period that followed, Boughton likened the IMF's structural adjustment work—providing member countries with short- and medium-term financial assistance, policy advice, and technical assistance—to one leg of a three-legged stool. The other two legs are

- the country's own responsibility for designing and implementing appropriate economic and financial policies, and
- long-term aid provided by national aid agencies and other international financial institutions, such as the World Bank and regional development banks.

Only if all three legs are solidly in place will the stool provide satisfactory support for adjustment programs.

Although the IMF's approach to its members' problems remains primarily economic, Boughton noted that the organization has broadened its approach to adjustment—and to country work more generally—by drawing on insights gleaned from the other social sciences. In response to Alexander's

suggestions that the IMF should support efforts to achieve a more equal income distribution in member countries undertaking adjustment programs, Boughton stated that, practically speaking, the IMF cannot say to its member countries, "We will finance your programs only if they move the distribution of income in a way that we like."

Responding to Alexander's criticism that the IMF is unwilling to challenge member countries' policies, Boughton said that "the IMF is far more likely now than it was 20 years ago to tell a country its policies are structurally deficient. If a country is cutting back on social programs while pursuing military spending that serves no purpose but to prop up an unpopular government, the IMF may recommend changes before approving a program." ■

Adjusting to Development: The IMF and the Poor, by Boris Bernstein and James M. Boughton, is No. 93/4 in the IMF's Papers on Policy Analysis and Assessment series. Copies are available free of charge from Publication Services, Box S-384, International Monetary Fund, Washington, DC 20431, U.S.A. (Telephone: (202) 623-7430; fax: (202) 623-7201.)

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From the Executive Board . . .

Latvia: Stand-By Arrangement and Systemic Transformation Facility. The IMF has approved credits to Latvia totaling SDR 45.75 million (about $63 million) in support of the Government's 1993/94 economic program. Of this total, the equivalent of SDR 22.875 million (about $32 million) may be drawn under a 15-month stand-by arrangement, and a further SDR 22.875 million is available under the systemic transformation facility (STF).

Latvia's 1992/93 economic program, supported by the IMF, achieved a large degree of macroeconomic stabilization. As a result of a tight monetary policy and a broadly balanced general government budget, inflation was reduced rapidly from a monthly rate of 20 percent in July 1992 to low single digits during 1993. A key element of the program was the introduction of a national currency in July 1992, which enabled the Bank of Latvia to pursue an independent monetary policy. Under structural reform, progress was more modest—especially in privatization—and the economy was unable to absorb fully the available balance of payments assistance. As a result, output declined more sharply, while the external current account recorded surpluses and international reserves rose markedly.

Latvia's 1993/94 economic program is designed to continue macroeconomic stabilization efforts but also to reinforce the economic reform process within a medium-term perspective. The main objectives of the program are to consolidate the gains achieved so far and to create the basis for sustained growth with a viable balance of payments, while keeping the underlying average monthly rate of inflation at about ½ of 1 percent through the program period. GDP growth may be achieved in 1994, assuming the economy can absorb the large amount of foreign financing that may become available. On these assumptions, the current account of the balance of payments would move into a deficit equivalent to 7 percent of GDP next year, compared with an estimated surplus of 1 percent of GDP this year.

To attain the program's objectives, the authorities will continue to pursue restrained fiscal policies and will limit the general government financial deficit to not more than 2 percent of GDP in 1994. To put public finances on a more sustainable basis over the medium term, comprehensive tax legislation was approved by Parliament in October 1993, and the Government has adopted measures to improve tax administration. The Government also plans to strengthen further the institutional arrangements for planning and executing fiscal policies. To date, the nucleus of a functioning treasury has been established in the Ministry of Finance with the help of IMF technical assistance; banking arrangements have been streamlined; daily reports are produced on government account balances; and expenditure processing has been computerized. Monetary policy, consistent with the program's objectives, will remain tight, and the trade regime will be rationalized through a planned overhaul of the tariff system by mid-1994.

During the program period, structural reforms, particularly in the area of privatization, will be accelerated. The Government is setting up a State Property Fund to oversee all state property and a Privatization Agency with authority over the privatization of large-scale enterprises. The process of restituting land and residential property to former owners is to be simplified and accelerated.

Given the uncertainties over the unemployment outlook for 1994, as well as the significant steps taken toward a system in which means-tested social benefits play a larger role, the Government's 1994 budget will include a sharp increase in social assistance payments. Average pensions were increased by about 50 percent from November 1, 1993, and pensioners and other needy persons will receive means-tested support payments to cover heating costs through the social assistance network at the local government level.

Latvia became a member of the IMF on May 19, 1992, and its quota is SDR 91.50 million (about $127 million). Latvia's outstanding financial obligations to the IMF arising from past operations and transactions currently total the equivalent of SDR 54.9 million (about $76 million).

Press Release No. 93/50, December 15, 1993

Moldova: Stand-By Credit and Systemic Transformation Facility. The IMF has approved credits totaling SDR 74.25 million (about $103 million) for Moldova to support the Government's 1993/94 economic and financial program. Of this total, up to SDR 51.75 million (about $72 million) may be drawn over the next 15 months under a stand-by credit and SDR 22.5 million (about $31 million) is available as Moldova's second drawing under the systemic transformation facility (STF).

Economic activity in Moldova continued to decline sharply in 1993—by a projected 15 percent—after a difficult 1992, reflecting the ongoing restructuring of the economy, much lower-than-expected energy imports, and persistent difficulties in obtaining key raw materials from other states of the former Soviet Union.

Inflation accelerated in the autumn of 1993 owing to a flight from Moldovan coupons—a transitional currency—following the announcement of the currency conversion in Russia, a larger-than-anticipated upward adjustment in administered prices, and higher-than-expected energy costs.

The balance of payments also came under severe pressure in 1993, reflecting the effects of the 1992 drought and higher energy costs. Nevertheless, important progress was achieved: the fiscal position improved; the privatization process was launched; and the new currency, the leu, was introduced on November 29, 1993 with the full support of the IMF.

The economic program seeks to reduce substantially the monthly level of inflation and to achieve price stability in 1994; to contain the decline in output to 3 percent of GDP in 1994; and to build up the level of gross international reserves.

To achieve these objectives, monetary and credit policy will be consistent with the targeted reduction in inflation; monetary policy will continue to promote market forces in the determination of interest rates and in the allocation of central bank credit. In support of this, the overall budget deficit in 1994 will be brought below 3.5 percent of GDP. Exchange rate policy will aim at achieving and maintaining a unified, market-determined, official exchange rate; and foreign exchange regulations will be reviewed to ensure they are consistent with current account convertibility.

The program also envisages a broad range of structural reforms: trade and prices will be liberalized further, augmenting the actions already taken under the STF-supported program; most state-owned enterprises will be privatized; and direct state intervention in economic activity, including the use of state orders, will be reduced considerably. These measures will be supported by a tightening of budget constraints on public enterprises and the reform of the financial sector.

Special measures to protect the most vulnerable segments of the population have also been incorporated in the program to facilitate price liberalization and the elimination of open-ended subsidies. Existing social protection arrangements will be reformed to ensure effective coverage of the targeted group and to ensure its long-term viability.

Moldova joined the IMF on August 12, 1992, and its quota is SDR 90 million (about $125 million). Moldova's outstanding financial obligations to the IMF currently total SDR 36 million (about $50 million).

Press Release No. 93/51, December 17, 1993

South Africa: Compensatory and Contingency Financing Facility. The IMF has approved a drawing by South Africa equivalent to SDR 614.43 million (about $849 million) under the compensatory and contingency financing facility (CCFF). The drawing, South Africa's first use of IMF credit since 1982, would help compensate for a shortfall in merchandise export earnings and an unexpected increase in cereal imports for the 12-month period ended June 1993.

Earnings from exports of various minerals such as gold and platinum have declined sharply, primarily because of lower world market prices. In addition, export earnings from agricultural crops dropped as a result of the severe drought, one of the worst this century, that swept southern Africa in early 1992. The increase in cereal imports also stems from the 1992 drought. The drought sharply reduced South Africa's production of maize (the staple food crop) and other food crops. As a consequence, the country was forced to import about 1 million metric tons of maize in the year ended June 1992 and another 3.3 million metric tons in the following year. It normally exports about 1–2 million metric tons a year.

South Africa's macroeconomic management in recent years has been aimed at achieving financial stability in difficult circumstances. South Africa has maintained a constructive policy dialogue with the IMF through regular consultations and staff visits. For the period ahead, the authorities are resolved upon a cautious fiscal and monetary stance that is broadly supported by South Africa's major nongovernmental political groups.

South Africa joined the IMF on December 27, 1945, and its quota is SDR 1,365.4 million (about $1,887 million). South Africa has no outstanding financial obligations to the IMF.

Press Release No. 93/52, December 22, 1993

Kenya: Enhanced Structural Adjustment Facility. The IMF has approved a loan equivalent to SDR 45.23 million (about $63 million) under the enhanced structural adjustment facility (ESAF) for Kenya in support of the Government's economic and financial program covering October 1993-September 1994. The loan is available in two equal installments, the first of which can be disbursed immediately.

Since the early 1990s, Kenya's economic situation has worsened. Economic growth fell from 4.4 percent in 1990 to 0.4 percent in 1992, inflation accelerated, and external payments arrears emerged. By March 1993, the economy was in crisis with severe shortages of foreign exchange and prospects of factory closings and layoffs adding to already high unemployment; inflation rose to 58 percent on an annual basis in the first quarter of 1993.

Several factors contributed to this situation: a series of exogenous shocks, including a large influx of refugees from neighboring countries and unfavorable export prices; unsettled social and political conditions during the democratization process; and the suspension of balance of payments assistance from bilateral donors in late 1991. In April 1993, the Government

adopted a macroeconomic framework to restore balance to the economy and resume the economic reform process. Monetary policy was tightened; steps were taken to stabilize the financial system; the exchange and trade system and maize marketing were substantially liberalized; civil service reform was initiated; and expenditure controls were strengthened. As a result, progress has been made toward stabilizing the economy.

The Government's economic program, which the ESAF loan supports, seeks to achieve economic growth of 3 percent in 1994; reduce the rate of inflation to 10 percent; attain relative exchange rate stability; lower the external current account deficit, excluding official transfers, to 1.5 percent of GDP; and raise the level of gross international reserves.

To achieve these objectives, fiscal policy is designed to reduce the overall budget deficit to 6.1 percent of GDP primarily through cuts to government expenditure. Measures to widen the tax base and improve tax administration, expand coverage of the value-added tax, and strengthen the collection of arrears from parastatals are also incorporated in the program. Monetary and credit policies have been formulated to support the inflation objectives.

On the structural side, the authorities will pursue a broad reform to improve the efficiency of government operations, rationalize the structure of government, reduce civil service, and privatize at least 20 nonstrategic public enterprises. Procedures for trade licensing and investment will be simplified; the pricing and marketing of maize will be decontrolled; and the Government will withdraw from agricultural processing to allow the private sector to expand into these activities.

To alleviate the adverse impact of the maize price liberalization, the Government will put in place a program to assist the poor, and is introducing programs to help laid-off civil servants start their own small-scale businesses or find alternative employment in the private sector.

Kenya joined the IMF on February 3, 1964, and its quota is SDR 199.40 million (about $276 million). Kenya's outstanding financial obligations to the IMF currently total SDR 241.73 million (about $334 million).

Press Release No. 93/53, December 23, 1993

Stand-By, EFF, SAF, and ESAF Arrangements As of November 30, 1993

(million SDRs)

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
Stand-by arrangements			**1,747.48**	**1,381.30**
Costa Rica	April 19, 1993	February 18, 1994	21.04	21.04
Czech Republic	March 17, 1993	March 16, 1994	177.00	107.00
Dominican Republic	July 9, 1993	March 28, 1994	31.80	28.00
El Salvador	May 10, 1993	March 9, 1994	34.55	34.55
Estonia	October 27, 1993	March 26, 1995	11.63	9.30
Guatemala	December 18, 1992	March 17, 1994	54.00	54.00
Hungary	September 15, 1993	December 14, 1994	340.00	283.30
Jordan	February 26,1992	February 25, 1994	44.40	11.10
Kyrgyz Republic	May 12, 1993	April 11, 1994	27.09	15.48
Lithuania	October 22, 1993	March 21, 1995	25.88	20.70
Pakistan	September 16, 1993	September 15, 1994	265.40	177.40
Panama	February 24, 1992	December 23, 1993	93.68	58.83
Poland	March 8, 1993	March 7, 1994	476.00	476.00
Viet Nam	October 6, 1993	October 5, 1994	145.00	84.60
EFF arrangements			**4,124.98**	**1,804.06**
Argentina	March 31, 1992	March 30, 1995	2,483.15	890.00
Egypt	September 20, 1993	September 19, 1996	400.00	400.00
Jamaica	December 11, 1992	December 10, 1995	109.13	72.75
Peru	March 18, 1993	March 17, 1996	1,018.10	375.41
Zimbabwe	September 11, 1992	September 10, 1995	114.60	65.90
SAF arrangements			**83.23**	**38.27**
Comoros	June 21, 1991	June 20, 1994	3.15	2.25
Ethiopia	October 28, 1992	October 27, 1995	49.42	14.12
Rwanda	April 24, 1991	April 23, 1994	30.66	21.90
ESAF arrangements			**1,864.65**	**713.74**
Albania	July 14, 1993	July 13, 1996	42.36	33.89
Benin	January 25, 1993	January 24, 1996	46.95	31.30
Bolivia	July 27, 1988	March 31, 1994	163.26	13.61
Burkina Faso	March 31, 1993	March 30, 1996	48.62	39.78
Burundi	November 13, 1991	November 12, 1994	42.70	23.49
Equatorial Guinea	February 3, 1993	February 2, 1996	12.88	10.12
Guinea	November 6, 1991	November 5, 1994	57.90	40.53
Guyana	July 13, 1990	December 20, 1993	81.52	–
Honduras	July 24, 1992	July 23, 1995	40.68	27.12
Lao P.D.R.	June 4, 1993	June 3, 1996	35.19	29.33
Lesotho	May 22, 1991	August 1, 1994	18.12	3.78
Malawi	July 15, 1988	March 31, 1994	66.96	5.58
Mali	August 28, 1992	August 27, 1995	60.96	40.64
Mauritania	December 9, 1992	December 8, 1994	33.90	16.95
Mongolia	June 25, 1993	June 24, 1996	40.81	31.54
Mozambique	June 1, 1990	December 1, 1993	100.65	–
Nepal	October 5, 1992	October 4, 1995	33.57	22.38
Sri Lanka	September 13, 1991	September 12, 1994	336.00	112.00
Tanzania	July 29, 1991	July 28, 1994	181.90	96.30
Uganda	April 17, 1989	November 24, 1993	219.12	19.92
Zimbabwe	September 11, 1992	September 10, 1995	200.60	115.50
TOTAL			**7,820.32**	**3,937.37**

Note: EFF = extended Fund facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals because of rounding.

Data: IMF Treasurer's Department

IMF Lending In November

On November 1993, Estonia drew SDR 11.6 million under a systemic transformation facility (STF) loan approved in October and SDR 2.3 million under a stand-by arrangement. Argentina drew SDR 167.0 million under an extended arrangement.

At November's end, 43 arrangements were in effect, including 14 stand-by arrangements, 5 extended arrangements, 3 structural adjustment facility arrangements and 21 enhanced structural adjustment facility arrangements. ■

Assigning a Policy Role for the Exchange Rate: A Case Study in Cape Verde

How to peg, or whether to peg, ought not be the first questions countries ask themselves when they review their exchange rate options. More basic, and critical—but rarely addressed in exchange rate research—is the method by which countries assign an economic policy instrument to a specific macroeconomic objective.

Recent discussions between IMF and Cape Verdean officials on exchange rate management in that small island economy provide a case study of how the search for an optimal peg can be broadened into a useful discussion of goals and means that then clarifies the choices open to the country and allows the decision-making process to proceed on a straightforward assessment of costs and benefits. This article is based on an IMF report prepared by a staff team headed by Klaus-Walter Riechel of the African Department.

Background

It was not a crisis that prompted Cape Verdean officials to re-examine the management of their exchange rate in 1993. Until 1976, the Cape Verde escudo had been on a par with the Portuguese escudo. It remained linked to the Portuguese currency, albeit at changing parities, until 1977, when the country adopted a managed basket peg after Portuguese officials began to place increased emphasis on exchange rates in managing their own economic strategy.

In the years since the delinking, the nominal effective exchange rate of the Cape Verde escudo has remained relatively stable within a narrow band, despite a 50 percent appreciation against the Portuguese escudo. And, with the exception of a few brief divergences, Cape Verde's real effective exchange rate followed the same steady path.

Stimulus for a re-examination of the exchange rate derived instead from a major shift in Cape Verde's economic policy environment. The country opted to move away from what had been a ubiquitous role for the Government in economic decision making to one that placed a new emphasis on private initiative and economic liberalization. Cape Verde sought to create an economic climate that would instill confidence in the country's economic management and stabilize the expectations of its economic agents. To achieve both, the IMF staff report contends, Cape Verde required a "clear and transparent set of policy objectives and an unequivocal assignment of policy instruments."

A Question of Assignment

At its heart, the staff report notes, the choice of an appropriate exchange rate is an assignment problem. Exchange rate policy can, in suitable circumstances, be effectively enlisted to help meet such diverse objectives as restraining inflation or addressing questions of external balance, competitiveness, and capital inflows. But the effectiveness of the exchange rate instrument can be undercut by assignment to inappropriate or multiple goals. It is vital that a policy instrument be assigned to an objective for which there is, in that particular country environment, a comparative advantage.

In Cape Verde's case, the economy is characterized by a narrow production base and a correspondingly high level of imports (50 percent of GDP), as well as a very low level of merchandise exports. With little scope for import substitution and no apparent comparative advantage in the production of a wider range of goods, Cape Verde's economy is marked by very low price elasticities for import demand and export supply.

The report notes a similar price inelasticity as it pertains to capital flows and private transfers in the form of work remittances from the many Cape Verdeans living abroad. These remittances have fluctuated little over time, and when they do vary, they appear to be primarily influenced by incomes of the remittants and the perceived needs of the recipients. Neither remittances nor private capital flows appear to be significantly affected by concerns about covered interest arbitrage.

With trade flows, private transfers, and capital flows all highly price inelastic, the study maintains that there would be no comparative advantage to using exchange rate policy to achieve competitiveness or demand management objectives or to influence the level of remittances of private inflows of foreign exchange. On the other hand, the report observes, "roughly half of all domestic prices are directly affected by the exchange rate, and another significant percentage [is affected] through open or informal indexation mechanisms."

This suggests that in Cape Verde's circumstances, the most pertinent and effective role for the exchange rate would be to maintain low domestic inflation. Having the exchange rate pursue multiple goals—particularly in a transition period in which clarity of purpose and transparency are sought—might introduce uncertainty, the report cautions, and call into question

the credibility of the authorities' commitment to price stability.

With the exchange rate assigned to the inflation objective, the competitiveness objective is best pursued through an appropriate incomes policy, and through structural policies that raise productivity. In addition, the objective of external balance will need to be bolstered through judicious domestic demand management, with fiscal policy concentrating on government net saving, and monetary policy concentrating on control of private sector spending.

Which Exchange Rate Regime?

Once Cape Verde had assigned a policy objective to its exchange rate management, the matter of what constitutes an appropriate exchange rate regime and more specific questions—such as which currencies to peg to and at what weights—became "straightforward."

The first issue for Cape Verde to resolve is the ambitiousness of its inflation objective. If Cape Verde wishes to pursue an inflation performance comparable to its trading partner with the lowest rate, it should opt for a single peg to that partner's currency. If, however, it is satisfied with an inflation performance that approximates an average of the inflation performance of its trading partners, an exchange rate pegged to a basket of its major trading partners would be sufficient.

Each option offers potential advantages and disadvantages. The report notes that establishing a link with the lowest inflation rate among its trading partners might entail, at least temporarily, "a gradual appreciation of the

Currency Units per SDR

DECEMBER

Currency	1	2	3	6	7	8	9	10	13	14
Deutsche mark	2.37766	2.38011	2.38279	2.37296	2.36678	2.37103	2.36936	2.35859	2.3565	2.37233
French franc	8.20306	8.19659	8.18596	8.15092	8.14672	8.14324	8.10868	8.07796	8.09571	8.10606
Japanese yen	150.478	150.122	150.558	150.262	150.159	149.587	150.746	151.197	151.503	150.625
Pound sterling	0.935545	0.934329	0.930997	0.929241	0.928076	0.930268	0.9296220	.927758	0.9300370	.93032
U.S. dollar	1.3818	1.38234	1.38253	1.3881	1.39165	1.38892	1.38681	1.38904	1.38994	1.38506
Argentine peso	...	...	...	...	...	...	...	...	...	...
Australian dollar	2.0985	2.08624	2.06749	2.08017	2.07802	2.07953	2.06217	2.07041	2.07392	2.06387
Austrian schilling	16.6906	16.7374	16.7659	16.6947	16.6761	...	16.6611	16.6226	16.5806	16.683
Bahrain dinar	0.519557	0.51976	0.519631	0.521926	0.52326	0.522234	0.521441	0.522279	0.522617	0.520783
Bangladesh taka	55.0647	55.0662	55.0938	55.3158	55.4573	55.3485	55.2644	55.3532	55.3891	55.1946
Belgian franc	50.0868	50.2135	50.1755	49.9716	49.4558	49.4069	49.4952	49.4568	49.4471	49.5713
Brazilian cruzeiro	326.063	330.594	335.07	340.931	346.396	350.355	354.573	359.886	364.996	368.841
Canadian dollar	1.84249	1.83976	1.83697	1.84118	1.8406	1.8374	1.83855	1.84562	1.84765	1.84696
Colombian peso	1255.3	1256.31	1257.13	1262.84	1266.62	...	1262.88	1265.58	1266.94	...
Danish krone	9.36933	9.40475	9.386	9.37106	9.32197	9.31826	9.26528	9.2392	9.25978	9.2896
Finnish markka	8.0733	8.03292	8.03126	...	7.96901	7.9731	7.94822	7.93447	7.95199	7.98058
Greek drachma	340.372	341.535	341.955	341.334	340.293	339.744	338.936	337.946	337.992	339.437
Indian rupee	43.3471	43.364	43.37	43.5447	43.6561	43.5704	43.5042	43.5742	43.6024	43.4493
Indonesian rupiah	2910.07	2913.97	2914.37	2926.11	2930.81	2925.07	2923.4	2926.71	2928.6	2918.32
Iranian rial	2383.06	2379.46	2379.46	2379.46	2402.8	2422.86	2432.	2432.	2459.99	2454.63
Iraqi dinar	0.429543	0.42971	0.42977	0.431501	0.432605	0.431756	0.4311	0.431793	0.432073	0.430556
Irish pound	0.977989	0.980244	0.979337	0.978224	0.982457	0.982472	0.97987	0.976341	0.98035	0.97891
Italian lira	2371.42	2374.57	2378.97	2356.94	2325.66	...	2329.63	2324.78	2342.1	2341.78
Korean won	1116.22	1117.21	1118.19	1123.39	1126.12	1124.19	1122.48	1124.15	1124.74	1121.76
Kuwaiti dinar	0.412578	0.412806	...	0.414334	0.414767	0.413954	0.413561	...	0.414258	0.412803
Libyan dinar	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429
Malaysian ringgit	3.53506	3.5352	3.53582	3.54701	3.55177	3.54786	3.54205	3.54552	3.54615	3.52969
Maltese lira	0.544659	0.546013	0.546023	0.544909	0.543422	...	0.542273	0.542742	...	0.542098
Nepalese rupee	68.0398	68.0664	68.0758	68.35	68.5248	68.3904	68.2865	68.3963	68.4406	68.2004
Netherlands guilder	2.66397	2.66626	2.67049	2.66002	2.65471	2.65562	2.64908	2.63987	2.64658	2.35696
New Zealand dollar	2.52753	2.52574	2.51781	2.52795	2.5286	...	...	...	2.50665	2.49246
Norwegian krone	10.3082	10.3358	10.331	10.3094	10.269	10.2947	10.2804	10.2801	10.248	10.2785
Omani rial	0.531302	0.53151	0.531583	0.533724	0.535089	0.53404	0.533228	0.534086	0.534432	0.532556
Pakistan rupee	41.627	41.6433	41.649	41.8168	41.9516	41.8693	41.8057	41.8729	41.8963	41.7529
Portuguese escudo	...	243.104	243.552	242.986	241.567	...	241.004	241.585	241.82	242.369
Qatar riyal	5.02975	5.03172	5.03241	5.05268	5.06561	5.05567	5.04799	5.05611	5.05938	5.04162
Saudi Arabian riyal	5.17484	5.17686	5.17757	5.19843	5.21173	5.20151	5.1936	5.20195	5.20533	5.18705
Singapore dollar	2.21088	2.21133	2.21371	2.22152	2.22441	2.22006	2.21723	2.22024	2.21821	2.20779
South African rand	4.65736	4.65779	4.65982	4.67026	4.67942	4.67719	4.668	4.6637	4.68201	4.67666
Spanish peseta	194.917	195.297	196.582	...	193.439	...	193.321	193.09	194.175	193.576
Sri Lanka rupee	68.3611	68.4569	68.4733	68.7422	68.847	68.7127	68.5951	68.7054	68.7499	68.5155
Swedish krona	11.7405	11.7022	11.6451	11.6246	11.5354	11.5683	11.5306	11.4908	11.6546	...
Swiss franc	2.07615	2.06936	2.07117	2.05022	2.03948	2.04102	2.0393	2.02522	2.02445	2.03465
Thai baht	35.1392	35.1529	35.1577	...	35.3201	35.2508	35.2388	...	35.3184	35.1944
Trinidad and Tobago dollar	7.94861	7.94341	7.93854	7.99714	7.97646	8.00032	7.96433	7.96645	8.09875	8.04138
U.A.E. dirham	5.07259	5.07457	5.07527	5.09572	5.10875	5.09873	5.09098	5.09917	5.10247	5.08456
Venezuelan bolivar	142.484	142.727	142.954	...	144.105	144.031	143.951	144.321	144.623	144.323

Notes: 1. The value of U.S. dollar in terms of the SDR is the reciprocal of the sum of the dollar values, based on market exchange rates, of specified quantities of the first five currencies shown. The exchange rates used for this purpose are noon rates in the London foreign exchange market. When the London market is closed, noon rates in the New York market are used. Frankfurt fixing rates are used when the New York market is closed. 2. The value in terms of the SDR of each of the other currencies shown above is derived from that currency's representative exchange rate against the U.S. dollar as reported by the issuing central bank and the SDR value of the U.S. dollar, except for the Iranian rial and the Libyan dinar, the values of which are officially expressed directly in terms of the domestic currency units per SDR.

Data: IMF Treasurer's Department

domestic currency in real effective terms and a corresponding loss of competitiveness." If, as is likely, it increases the variability of bilateral exchange rates with other trading partners, it would also heighten the degree of uncertainty, which would likely have an undesirable effect on its trade and payment flows. (These effects will be greater if Cape Verde's low inflation partner represents only a small share of its overall trade.)

Aiming at an average, and thus less ambitious, inflation target, however, raises the prospect of diminished confidence in the stability of Cape Verde's economy and may undermine the credibility of its policies. The report urges the pursuit of a "sufficiently ambitious inflation objective," which would, at the very least, "put pressure on wages and profits, and thereby strengthen the need for efficient production."

A second consideration for Cape Verde is the impact of its choice of regime and country weights on the stability of its currency. Remittances from the United States are a major element in Cape Verde's economy; does this argue for integrating the U.S. dollar into its basket of currencies? The report weighs the pros and cons, and finds little justification for including the U.S. dollar. Inclusion would do little to increase the flow of remittances but could inject a great deal more variability in the Cape Verde escudo's nominal exchange rate, with an even greater impact on the variability of bilateral rates with other partners.

Currency Units per SDR

DECEMBER

Currency	15	16	17	20	21	22	23	24	27	28
Deutsche mark	2.37384	2.36983	2.36416	2.36782	2.36242	2.35472	2.35495	...	2.35753	2.35488
French franc	8.10683	8.09345	8.08319	8.07675	8.04612	8.03002	8.02587	8.01247	8.03094	8.02312
Japanese yen	151.199	151.873	152.053	152.262	152.921	153.749	...	153.414	153.936	154.509
Pound sterling	0.930491	0.931196	0.930034	0.929873	0.928964	0.927419	0.9247230	.923397	...	...
U.S. dollar	1.38271	1.38255	1.38482	1.38194	1.38202	1.38139	1.38616	1.38648	1.38369	1.38449
Argentine peso	...	...	...	...	...	...	...	...	...	...
Australian dollar	2.05394	2.04671	2.05311	2.03646	...	2.03205	2.04057	2.04375	...	...
Austrian schilling	16.6948	16.6853	16.6275	16.6565	16.6229	16.567	16.5563	...	16.5786	16.564
Bahrain dinar	0.519899	0.519839	0.520892	0.519609	0.51964	0.519403	0.521196	0.521316	0.520267	0.520568
Bangladesh taka	55.101	55.0946	55.1851	55.0703	55.0735	55.0484	55.2385	55.2512	55.14	55.1719
Belgian franc	49.6116	49.4365	49.3861	49.3145	49.0168	48.915	48.9626	49.0086	...	49.0629
Brazilian cruzeiro	373.406	378.646	384.599	389.23	394.753	400.168	407.337	413.129	418.165	424.596
Canadian dollar	1.84301	1.84114	1.85386	1.85857	1.85702	1.84277	1.83805	1.83889	...	...
Colombian peso	1261.63	1262.24	1265.03	1263.08	1263.8	1263.99	1269.11	...	1267.6	1268.9
Danish krone	9.29665	9.2776	9.26929	9.27351	9.24364	9.21663	9.2041	...	9.20777	9.19994
Finnish markka	8.04447	8.00745	8.03209	8.00129	7.96596	7.8992	7.84872	...	7.89312	7.90156
Greek drachma	339.925	339.43	339.835	339.612	338.851	338.206	338.362	337.469	338.478	338.425
Indian rupee	43.3756	43.3706	43.4418	43.3515	43.354	43.3342	43.4838	43.4939	43.4064	43.4315
Indonesian rupiah	2916.14	2917.18	2920.59	2913.13	2914.66	2913.35	2922.03	2921.31	2916.82	2918.5
Iranian rial	2446.02	2447.87	2447.87	2431.74	2419.78	2417.15	2416.05	2416.05	2424.95	2420.07
Iraqi dinar	0.429626	0.429776	0.430481	0.429586	0.429611	0.429415	0.430898	0.430997	0.43013	0.430379
Irish pound	0.978633	0.977689	0.975913	0.977119	0.970792	0.970077	0.968665	0.968145	...	...
Italian lira	2337.29	2341.28	2338.74	2329.8	2313.13	2306.95	...	2303.64	2325.5	2326.37
Korean won	1121.1	1120.83	1122.26	1119.92	1121.65	1121.27	1123.48	1120.69	1117.74	1118.81
Kuwaiti dinar	0.412338	0.41229	...	0.412108	0.412132	0.411944	0.413367	...	0.412409	0.412613
Libyan dinar	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429	0.446429
Malaysian ringgit	3.52702	3.52592	3.53143	3.52561	3.52664	3.526	3.54649	3.56117	3.5713	...
Maltese lira	0.542622	0.543391	0.542174	0.541237	0.541183	0.540091	0.540476	0.539277	0.538527	0.539426
Nepalese rupee	68.0846	68.0768	68.1885	68.0467	68.0507	68.0196	68.2545	68.2703	68.1329	68.1723
Netherlands guilder	2.65743	2.65311	2.64784	2.65429	2.64463	2.63845	2.63788	2.63681	2.64133	2.63939
New Zealand dollar	2.48599	2.4662	2.46981	2.47261	2.45999	2.46105	2.4606	2.47896	...	...
Norwegian krone	10.3026	10.2869	10.274	10.2892	10.2428	10.2216	10.2077	10.1962	10.2227	10.2189
Omani rial	0.531652	0.53159	0.532463	0.531356	0.531387	0.531144	0.532979	0.533102	0.532029	0.532336
Pakistan rupee	41.7237	41.7189	41.7874	41.7005	41.7029	41.6839	41.8555	41.8652	41.7809	41.8051
Portuguese escudo	242.041	242.078	241.636	241.45	241.838	240.959	240.883	...	240.148	240.282
Qatar riyal	5.03308	5.03248	5.04074	5.03026	5.03055	5.02626	5.04562	5.04679	5.03863	5.03954
Saudi Arabian riyal	5.17825	5.17765	5.18615	5.17537	5.17566	5.17331	5.19117	5.19237	5.18192	5.18492
Singapore dollar	2.20528	2.20544	2.20768	2.2024	2.20253	2.20152	2.20912	2.2106	2.21003	2.21712
South African rand	4.6784	...	4.68692	4.6827	4.67745	4.67531	4.67968	4.68006	4.68926	4.67335
Spanish peseta	193.759	195.362	194.332	193.941	193.345	193.491	193.425	...	193.537	193.496
Sri Lanka rupee	68.4061	68.4065	68.514	68.3715	68.3858	68.3546	68.5837	68.5857	68.4671	68.5066
Swedish krona	11.6438	11.6666	11.6408	11.6124	11.5993	11.5249	11.4109	...	...	11.4947
Swiss franc	2.02802	2.02751	2.01976	2.01763	2.00393	2.00232	1.99094	1.99445	1.99943	2.00128
Thai baht	35.1623	35.1859	35.216	35.1704	35.2	35.1978	35.2916	35.2998	35.2564	35.2768
Trinidad and Tobago dollar	8.01589	7.98922	8.04881	7.99112	8.02694	7.99561	8.06217	8.01484	...	8.03438
U.A.E. dirham	5.07593	5.07534	5.08367	5.0731	5.0734	5.07108	5.08859	5.08977	5.07953	5.08246
Venezuelan bolivar	144.217	144.338	144.783	144.689	144.905	145.046	145.685	145.927	145.841	146.064

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Data: IMF Treasurer's Department

Other Issues

The report raises two related issues. One is an analytical question, and the second concerns the appropriate level of the exchange rate. The first asks whether the country's fiscal and incomes policy might prove more expansive than intended. If structural deficiencies in economic policy management should arise, predictable adjustment in the exchange rate would be needed, it concludes.

Cape Verde, off the west coast of Africa, determined that the most effective role for its exchange rate was in maintaining low inflation.

The second issue concerns Cape Verde's success in implementing its new economic strategy. According to the study, this will depend in large measure on "appropriate supply incentives and the availability of significant external financial resources." Would a lower exchange rate stimulate private sector activity and entice greater foreign investment? Would Cape Verde be well advised to devalue its currency as a "once-and-for-all measure"?

The study weighs the potential benefits (greater profits and increased production incentives) and costs (a rapid and full spillover into the cost of electricity, water, and telecommunications, as well as a sharp increase in the cost of critical investment goods and a decrease in the real value of domestic savings—an effect often neglected in the analysis of exchange rate changes).

On balance, the report finds a one-time devaluation would likely have a negative impact on enterprises and entrepreneurs and thus undermine efforts to increase private sector investment. A one-time devaluation could improve competitiveness, relative prices, and demand on a lasting basis only if the endogenous effects of the devaluation could be completely controlled.

Conclusions

From this examination of Cape Verde's policy objectives and the assignment of an appropriate role for its exchange rate, the report draws four conclusions:

- Cape Verde's exchange rate should serve as the nominal anchor for its economy and should be assigned to the inflation objective.
- The country's circumstances favor a fixed exchange rate regime. The ambitiousness of the authorities' inflation objectives should determine both the type of peg used and the relative weights to be accorded.
- A more flexible exchange rate policy should be pursued only if the country finds itself in a sustained structural struggle to control either fiscal deficits or domestic wages. If a more flexible regime becomes necessary, Cape Verde should follow a predictable devaluation path.
- An active use of the exchange rate instrument to promote growth objectives appears unwarranted and may undermine credibility and predictability—elements that are critical for Cape Verde as it embarks on a new economic strategy. ■

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